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# Regional Outlook

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FEDERAL DEPOSIT INSURANCE CORPORATION

THIRD QUARTER 2001

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## FDIC ATLANTA REGION



DIVISION OF  
INSURANCE

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### *A Message to Our Readers*

The FDIC community extends its deepest sympathy to the families, friends, and co-workers of the victims of the attacks on September 11, 2001.

The articles in this edition of the *Regional Outlook* were prepared before the tragic events of September 11. We will assess the implications of these events in future issues of the *Regional Outlook*. The public can rest assured that deposit insurance is in full force—money is safe in an FDIC-insured account.

## Regional Perspectives

- ◆ The number of insured institutions and branch offices of community banks has increased in many of the Region's non-metropolitan counties. Community banks headquartered in these counties hold almost half of the Region's small bank assets.
- ◆ An analysis of banking markets in the Region's non-metropolitan counties suggests that community banks facing strong competition may have a heightened risk profile and face challenges that differ according to the structure of the local economy. *See page 3.*

*By the Atlanta Region Staff*

## In Focus This Quarter

- ◆ *Slowing Economy Reduces Demand for U.S. Office Space*—A slowing economy has contributed to softening in many U.S. office markets during the first half of 2001. The office vacancy rate has recorded the largest six-month increase in the past 20 years. A combination of trends—a substantial drop in demand for office space and an uptick in construction activity in some markets—has led to this slackening.

This article reviews recent developments in U.S. office markets and describes demand-side and supply-side trends that have contributed to the recent weakness. It notes the role played by the changing fortunes of high-tech firms in a number of U.S. metro areas and how this situation has contributed to large increases in the volume of space available for sublease. Finally, the article focuses on the local construction and commercial real estate loan exposures of FDIC-insured banks and thrifts that have the task of managing their risks under changing market conditions. *See page 11.*

*By Thomas A. Murray*

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## *Regional Perspectives*

- More than half of the Atlanta Region's community banks with assets of less than \$1 billion are headquartered in non-metropolitan counties and account for 47 percent of the Region's small bank assets.
- Although it is commonly believed that the number of insured institutions is shrinking, many non-metropolitan counties in the Atlanta Region have experienced growth in the number of institutions and branch offices.
- Community banks headquartered in non-metropolitan counties with ten or more competitors generally appear to exhibit a different risk profile and underperform compared with other non-metropolitan community banks.

### *Competitive Banking Markets in Non-Metropolitan Atlanta Region Counties*

The second quarter 2001 *Atlanta Regional Outlook* examined economic and competitive factors that could affect bank performance in metropolitan areas; however, some non-metropolitan counties may also share similar risk factors. Although economic activity and growth are concentrated in metropolitan areas,<sup>1</sup> understanding the dynamics of non-metropolitan counties may be important for managing risk in an uncertain economic environment. More than half of the Atlanta Region's community banks<sup>2</sup> are headquartered in non-metropolitan counties and account for 47 percent of the Region's small bank assets. Non-metropolitan counties with a comparatively large number of market participants may experience high levels of competition. The analysis presented in this article seeks to identify these types of markets and determine common economic and competitive factors that would affect community bank performance.

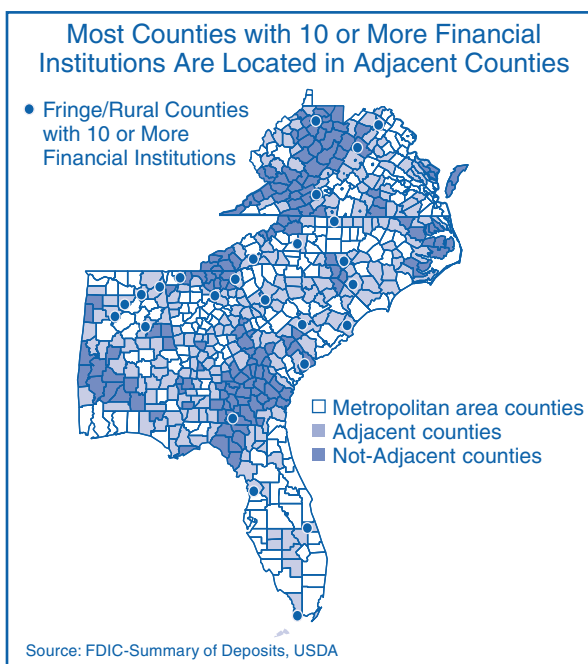
### *Market Identification*

In order to focus on areas where competitive pressures may be high, we considered non-metropolitan markets where ten or more insured institutions compete. Of the 424 non-metropolitan counties located in the Atlanta Region, only 25 have ten or more insured institutions with offices accepting deposits within the county. Of these 25, all but three were situated adjacent to metropolitan areas (see Map 1).

<sup>1</sup> According to *DRI-WEFA* and the Bureau of Labor Statistics, metropolitan areas accounted for three-quarters of the Atlanta Region's workforce of 23 million average job level in 2000 and 81 percent of the Region's 600,000 jobs added in 2000.

<sup>2</sup> Assets less than \$1 billion.

MAP 1



### *Classifying the Economies of Atlanta Region Non-Metropolitan Counties*

To conduct economic analysis at the local level, counties are often designated as metropolitan or non-metropolitan. Counties falling into either group generally are assumed to share economic characteristics. However, the Atlanta Region's rapid growth over the past decade and the increasingly important issue of urban sprawl have blurred the distinctions between many metropolitan and non-metropolitan counties, rendering this type of analysis insufficient. Consequently, it may be useful to refine the economic classification of non-metropolitan counties on the basis of shared economic drivers.

The U.S. Department of Agriculture's (USDA) Rural-Urban Continuum<sup>3</sup> codes represent a starting point for economic classification of non-metropolitan area counties. From these codes, one can differentiate among types of non-metropolitan counties by comparing geographic location and patterns of commuting. Counties bordering a metropolitan area with at least 2 percent of the workforce commuting to that metropolitan area are defined as "Adjacent." Otherwise the counties are identified as "Not Adjacent." The utility of these codes, however, may be limited for analysis because of the rapid growth in the Atlanta Region during the 1990s; the data used in the development of these codes are based primarily on the results of the 1990 U.S. Census.

### An Updated System of County Classification

A more accurate definition of the relationship between Adjacent counties and their respective metropolitan areas that are home to a comparatively large number of insured institutions needed to be developed. As a result, we modified a methodology for measuring systemic and nonsystemic volatility between two economic entities using a portfolio approach.<sup>4</sup> Systemic volatility, in this instance, refers to the correlation between a county's employment growth and that of the neighboring metropolitan area. Nonsystemic volatility refers to changes in a county's employment growth not attributable to a neighboring metropolitan area. The results of this analysis enabled us to classify 22 Adjacent counties in the Atlanta Region with a large number of insured institutions accepting deposits during the 1990s into the following three groups:

**Dependent.** The *Dependent* classification refers to Adjacent counties where systemic volatility exceeds nonsystemic volatility, reflecting the fact that the Adjacent county's economy is tied closely to the bordering metropolitan area.<sup>5</sup> In many circumstances, these counties display high levels of economic development often attributed to the effects of urban sprawl. Dependent counties displayed the highest level of economic growth and per capita income of the three Adjacent types. Despite rapid growth, the median level of economic diversification<sup>6</sup> was low compared with that of the other county types. This measure, however, may have been skewed by the high level of specialization found in two Dependent counties.<sup>7</sup> Nine of the 22 Adjacent counties fell into the Dependent category.

**Independent.** *Independent* counties have a nonsystemic volatility that is greater than systemic volatility and account for the smallest share of Adjacent counties.<sup>8</sup> Typically, these counties have economies that remain heavily dependent on a particular local industry, although spillover growth from bordering metropolitan areas likely continues to play an increasingly larger role in the local economy. A good example of this would be **Walker County, Alabama**, where coal mining, despite declines, remains vital to the local economy. These counties tended to have the least diversified local economies. Five of the 22 Adjacent counties fell into the Independent category.

**Mixed.** Counties where neither systemic or nonsystemic volatility appeared to dominate were classified

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<sup>3</sup> For a complete discussion of how the Rural-Urban Continuum codes (commonly referred to as "Beale Codes") were developed, visit the USDA website at [www.ers.usda.gov/briefing/rurality/RuralUrbCon/](http://www.ers.usda.gov/briefing/rurality/RuralUrbCon/).

<sup>4</sup> The technique for measuring volatility was adapted from "Assessing Regional Economic Stability: A Portfolio Approach," Carolyn Sherwood-Call, Federal Reserve Bank of San Francisco, *Economic Review*, Winter 1990, Number 1. After testing data from several sources, we used county and metropolitan household employment survey data as our proxy for economic growth during the period 1990 to 2000. The standard deviation of data for a county measures the total volatility. By using the  $R^2$  of a regression between a county and the relevant metropolitan area of the household employment survey data as an estimation of the degree of dependency, we separated the volatility into systemic and nonsystemic components. A high measure of systemic volatility would indicate that local growth is strongly correlated with fluctuations in the adjacent metropolitan area. Higher nonsystemic volatility may indicate that local growth is dependent on other economic factors, such as a particular industry that may be dependent on exports or on continued strong demand at the national level.

<sup>5</sup> We identified nine Adjacent Dependent counties: Cullman, DeKalb, and Marshall counties in Alabama; Citrus and Indian River counties in Florida; Hall and Whitfield counties in Georgia; Iredell County, NC; and Georgetown County, SC.

<sup>6</sup> Comparative measures of economic diversification were developed from methods used in "Industrial Composition of State Earnings in 1958-1998," G. Andrew Barnat Jr. and Eric S. Repice, *Survey of Current Business*, February 2000. The level of diversification can range from 0 to 100, with 100 being most like the industrial structure of the United States.

<sup>7</sup> The two counties that have become increasingly specialized are DeKalb County, AL, and Whitfield County, GA. DeKalb County actually has seen a significant rise in manufacturing's share of the local economy, where the sector accounted for half of all employment in 2000 compared to 42 percent ten years earlier. Whitfield County is the least diverse economy in our analysis (12.4 in a possible range of 0 to 100). The county's economy is heavily dominated by textiles or, more precisely, carpet manufacturing. Nonetheless, the county's level of diversity has risen from its nadir of 9.1 in 1998.

<sup>8</sup> Our analysis identified five Adjacent Independent counties: Walker County, AL; Moore and Rockingham counties in North Carolina; and Greenwood and Oconee counties in South Carolina.

as *Mixed*.<sup>9</sup> In most instances, these are counties in the midst of a structural economic transformation. Although spillover growth from the bordering metropolitan areas affects economic performance, local industry plays a dominant role. Eight of the 22 Adjacent counties are characterized by an economic structure in which growth is affected almost equally by conditions in the bordering metropolitan area and by local economic drivers.

### Not-Adjacent County Characteristics

Some counties in the Atlanta Region have a comparatively large banking presence despite the fact that they do not border a metropolitan area. We identified three such counties: **Lowndes County, GA; Beaufort County, SC; and Harrison County, WV.** The economic structure of these counties varies, but each would be classified by the USDA's Rural-Urban Continuum as an Urban Area with a population of 20,000 or more not adjacent to a metropolitan area. These counties display high levels of job growth and economic diversification compared with those of their Adjacent counterparts (see Table 1). This greater economic diversification may be explained by the fact that these counties do *not* border metropolitan areas. Consequently, they may be obligated to supply a broader range of services to their residents, and those of surrounding rural counties, than is the case in Adjacent counties where individuals could find necessary services in nearby metropolitan areas.

### General Banking Market Characteristics and Specific County Types

The annual *Summary of Deposits* data provide detailed information about market participants at the local level and can be used to analyze competitive conditions. Combining the economic classification system developed above and deposit market share data can provide a framework for analysis. By classifying our group of non-metropolitan counties with ten or more insured institutions into four groups (Adjacent Dependent, Adjacent Independent, Adjacent Mixed, and Not Adjacent), some patterns in banking market structure emerge. Using the June 30, 2000, Summary of Deposits and the FDIC's *ID System*<sup>10</sup> data, we have made some observations about market growth, competitive conditions, deposit characteristics, and the presence of locally owned community banks.

### Growth in Institutions and Branch Offices

Examining existing bank presence in non-metropolitan counties provides us with a snapshot of the local banking industry but does not address the issue of growth. Using Summary of Deposits data from 1994 and 2000, we can see how banking markets have evolved during the latter half of the 1990s.

It is commonly believed that the number of market participants in non-metropolitan areas is shrinking; however, this trend may not be consistent across all counties. With the exception of those classified as Independent, each of the 25 counties in our analysis experienced growth in the number of institutions and branch offices (see Table 2, next page). Similarly, county

TABLE 1

ECONOMIC DIVERSITY IS HIGHEST IN NOT-ADJACENT COUNTIES		
	MEDIAN ANNUAL JOB GROWTH, 1994–2000	MEDIAN LEVEL OF ECONOMIC DIVERSIFICATION, 2000
ADJACENT COUNTY TYPES		
DEPENDENT	1.8%	37
INDEPENDENT	1.3%	41
MIXED	1.4%	47
NOT-ADJACENT COUNTIES	2.9%	52
SOURCE: DRI-WEFA		

<sup>9</sup> Eight Adjacent Mixed counties were identified: Talladega County, AL; Monroe County, FL; Henderson and Robeson counties in North Carolina; Orangeburg County, SC; and Rockingham, Montgomery, and Frederick counties in Virginia. In our analysis, note that Rockingham and Frederick counties also include the independent cities of Harrisonburg and Winchester, respectively.

<sup>10</sup> The *FDIC Institution Directory* (ID) provides the latest comprehensive financial and demographic data of every FDIC-insured institution, including the most recent quarterly financial statements, as well as performance and condition ratios (see [www2.fdic.gov/idasp](http://www2.fdic.gov/idasp)).

TABLE 2

THE NUMBER OF MARKET PARTICIPANTS IN MOST COUNTY TYPES HAS INCREASED						
COUNTY TYPE		INSTITUTIONS		OFFICES		
		1994	2000	1994	2000	
ADJACENT	DEPENDENT	MEDIAN	12	12	28	36
		AVERAGE	11	13	30	34
		SUM	102	113	270	308
	INDEPENDENT	MEDIAN	10	11	28	27
		AVERAGE	11	11	30	29
		SUM	54	54	151	143
MIXED		MEDIAN	10	11	31	33
		AVERAGE	10	12	30	35
		SUM	79	93	237	277
NOT ADJACENT		MEDIAN	10	11	29	32
		AVERAGE	10	13	34	39
		SUM	31	38	101	116
SOURCE: FDIC—SUMMARY OF DEPOSITS, JUNE 30, 2000						

SOURCE: FDIC—SUMMARY OF DEPOSITS, JUNE 30, 2000

types characterized by the highest level of job growth between 1994 and 2000 (see Table 1) also experienced the largest gains in the number of institutions. As discussed in prior analyses (see *Atlanta Regional Outlook*, first quarter 2001), a link between economic or demographic growth and the supply of banking services appears to exist. This relationship may reflect the fact that market opportunities in slower growth areas may be limited.

## Market Competition

One factor that can affect the level of competition is the degree to which a market is concentrated. Our analysis indicates that market concentration can vary by county type. We used two methods to measure the degree to which a county's deposit market was concentrated: the Herfindhal-Hirschman Index<sup>11</sup> (HHI) and the combined deposit share of the three largest market participants, referred to in this article as the "top three firms measure." Both measures were calculated using Summary of

Deposits data, the results of which can be seen in Table 3. All market types were classified as "moderately concentrated." However, the Dependent and Not-Adjacent counties were comparatively less concentrated and, consequently, the degree of competition may be higher in these areas. While the HHI indicates a high degree of competition, the top three firms measure provides additional insight. *Typically, in these counties the three largest deposit market shares are held by superregional or regional banking companies. These firms usually offer extensive product lines and distribution systems, exhibit geographic diversification, and have significantly greater resources available in terms of financial capital, technology, and human resources, which may allow them to compete more strongly with smaller, locally owned firms.*

It is interesting to note that the level of market concentration among the Adjacent county types declined significantly between 1994 and 2000. On average, Independent counties would have been classified as highly concentrated markets in 1994. In contrast, Not-Adjacent counties as a group experienced little change in the level of market concentration, despite the large increase in number of competitors. If the trend toward less concentrated markets in the Adjacent counties continues, competitive pressures in the local banking industry, consequently, also may rise as insured institutions struggle to defend or expand market share.

<sup>11</sup> The HHI is calculated by taking the deposit shares of each financial institution in a county, squaring them, and then summing the squared values. A county with an HHI of more than 1,800 would be defined as "highly concentrated" by U.S. Department of Justice guidelines, while a county with an HHI of less than 1,000 would be regarded as "unconcentrated." A market with an HHI between 1,000 and 1,800 is classified as "moderately concentrated."

TABLE 3

ALL MARKET TYPES ARE "MODERATELY CONCENTRATED"				
COUNTY TYPE	HERFINDHAL-HIRSCHMAN INDEX		TOP THREE FIRMS MEASURE	
	MEDIAN	AVERAGE	MEDIAN	AVERAGE
ADJACENT				
DEPENDENT	1,353	1,418	56%	55%
INDEPENDENT	1,680	1,779	63%	62%
MIXED	1,769	1,846	63%	63%
NOT ADJACENT	1,527	1,478	58%	56%
SOURCE: FDIC—SUMMARY OF DEPOSITS, JUNE 30, 2000				

## Community Bank Presence

Another competitive factor that appears to vary somewhat by county type is the share of locally headquartered community banks in a market area. On average, in Dependent, Mixed, and Not-Adjacent counties that are home to at least ten insured institutions, one in four institutions were headquartered locally, while almost one in three have local headquarters in Independent counties (see Table 4). Locally headquartered banks in counties with a greater presence of superregional and regional banks, which may benefit from economies of scale, could experience an increasing level of competition. Consequently, local community banks may find it more challenging to preserve market share. In Dependent counties, market dynamics may be further complicated by the comparatively high presence of non-recession-tested community banks,<sup>12</sup>

which may face even greater competitive pressure because they often must seek to *expand* market share to ensure survival.

Financial performance of insured institutions during an economic downturn may be affected by the geographic scope of operations. Greater geographic diversification of a bank's lending portfolio and revenue stream may reduce exposure to local economic volatility. However, in the case of Dependent counties, if the bank is headquartered in the bordering metropolitan area, the insured institution may not actually be geographically diversified. In contrast, Independent counties, which have a greater share of locally headquartered community banks, may face a different set of risks. In this case, layoffs in a key industry could affect credit quality in an Independent county and, thus, have an adverse impact on this set of banks. Consequently, the performance of locally owned banks could be largely dependent on the economic classification of the county in which they are located.

TABLE 4

LOCALLY HEADQUARTERED BANK PRESENCE IS HIGHEST IN ADJACENT INDEPENDENT COUNTIES	
	AVERAGE
ADJACENT	
DEPENDENT	25%
INDEPENDENT	30%
MIXED	25%
NOT ADJACENT	24%
SOURCE: FDIC—SUMMARY OF DEPOSITS, JUNE 30, 2000	

<sup>12</sup> Community banks established after first quarter 1991. Twenty-four percent of banks (seven institutions) headquartered in counties of the Adjacent Independent group were non-recession-tested, compared with 22 percent of Not-Adjacent counties, 17 percent of Adjacent Mixed counties, and 13 percent of Adjacent Independent counties as of June 30, 2000.

## Deposit Characteristics

Evidence suggests that characteristics of deposits vary by county economic classification. However, the level of deposits and income correlated positively in each of the 25 identified counties. Furthermore, the Dependent and Not-Adjacent counties, which displayed the highest overall levels of per capita income, also held the highest levels of deposits per capita. From an economics perspective, this confirms that higher levels of income often result in greater savings.

Measures of deposits per institution and deposits per branch office also appear to correlate positively with the level of income. Generally, county types with higher levels of income also had higher deposits per institution and deposits per branch office.



## Recent Performance

Insured institution performance and risk profile also can vary significantly by geographic location and local economic structure. As seen in Table 5, the 69 community banks<sup>13</sup> headquartered in the 25 non-metropolitan counties with ten or more competitors generally appear to exhibit a different risk profile and underperform compared with other non-metropolitan banks. At year-end 2000, Atlanta Region community banks operating in these highly competitive areas held less capital and larger loan portfolios—with a greater concentration in real estate loans, particularly traditionally higher-risk construction and development loans—and relied more on borrowed funds due to lower levels of core deposits. These characteristics have also existed for much of the latest economic expansion, as seen in the performance data for year-end 1995 included in Table 5. The risk profile of these 69 community banks more closely resembles that of an urban bank than that of a typical non-metropolitan community bank. Also, although these markets exhibit more favorable growth potential than those in other non-metropolitan counties, these markets may be less desirable to large insured institutions if competitive forces limit profitability.

## Implications for Insured Financial Institutions

The economic structure of a non-metropolitan county that is home to ten or more insured institutions may contribute to differing patterns of market growth and opportunities and may play a role in local community bank performance. Lenders should recognize the fact that local markets in non-metropolitan counties differ in terms of the risks or opportunities they present.

Dependent counties appear to have a great deal in common economically with their respective bordering metropolitan areas. Consequently, the challenges faced by insured institutions that are headquartered there may resemble those in metropolitan areas. Throughout the 1990s, faster growth in the Dependent counties may have created market opportunities, allowing for *de novo* entrants into the market. The economic dependency of the Dependent counties, however, may be a double-edged sword. Several metropolitan areas in the Atlanta Region have experienced slow growth and rising unemployment rates in recent quarters. If this trend persists, any repercussions from weakening economies in those metropolitan areas likely will be experienced in their Dependent counties.

TABLE 5

COMMUNITY BANK <sup>1</sup> PERFORMANCE MEASURES DIFFER BY HEADQUARTERS LOCATION										
	NUMBER OF INSTITUTIONS	RETURN ON ASSETS (%)	NET INTEREST MARGIN (%)	CAPITAL TO ASSETS (%)	SECURITIES TO ASSETS (%)	LOANS TO ASSETS (%)	REAL ESTATE LOANS TO ASSETS (%)	C&D LOANS <sup>2</sup> TO ASSETS (%)	CORE DEPOSITS <sup>3</sup> TO ASSETS (%)	BORROWINGS TO ASSETS (%)
<b>2000</b>										
ATLANTA REGION TOTAL	1,105	1.13	4.51	10.17	21.8	66.5	45.0	5.9	67.3	4.0
METROPOLITAN COUNTY	568	1.10	4.52	10.39	20.5	66.9	45.6	7.5	66.6	3.7
NON-METROPOLITAN COUNTY	537	1.17	4.50	9.86	23.5	66.0	44.4	3.7	68.4	4.3
<b>MORE THAN 10 COMPETITORS<sup>4</sup></b>	<b>69</b>	<b>1.20</b>	<b>4.42</b>	<b>9.08</b>	<b>21.7</b>	<b>68.3</b>	<b>48.5</b>	<b>4.9</b>	<b>68.1</b>	<b>4.4</b>
FEWER THAN 10 COMPETITORS <sup>4</sup>	468	1.16	4.52	10.03	23.9	65.5	43.5	3.5	68.4	4.2
<b>1995</b>										
ATLANTA REGION TOTAL	1,289	1.24	4.80	9.75	25.3	62.2	40.7	3.3	74.4	1.7
METROPOLITAN COUNTY	644	1.19	4.86	9.43	23.3	63.3	42.0	4.1	74.0	1.9
NON-METROPOLITAN COUNTY	645	1.31	4.69	10.29	28.8	60.3	38.5	1.9	74.9	1.3
<b>MORE THAN 10 COMPETITORS<sup>4</sup></b>	<b>71</b>	<b>1.22</b>	<b>4.57</b>	<b>9.98</b>	<b>28.5</b>	<b>61.6</b>	<b>42.2</b>	<b>3.3</b>	<b>74.0</b>	<b>1.5</b>
FEWER THAN 10 COMPETITORS <sup>4</sup>	574	1.33	4.71	10.35	28.8	60.1	37.8	1.7	75.1	1.3
<sup>1</sup> COMMUNITY BANKS ARE COMMERCIAL BANKS AND STATE SAVINGS BANKS WITH ASSETS LESS THAN \$1 BILLION. <sup>2</sup> CONSTRUCTION AND DEVELOPMENT LOANS. <sup>3</sup> CORE DEPOSITS INCLUDES ALL DEPOSITS LESS TIME DEPOSITS IN AMOUNTS OF \$100,000 OR MORE. <sup>4</sup> COMPETITION IS DERIVED FROM THE NUMBER OF INSURED INSTITUTIONS ACCEPTING DEPOSITS WITHIN A COUNTY AS REPORTED IN JUNE 30, 2000, SUMMARY OF DEPOSIT DATA. SOURCE: BANK CALL REPORTS										

<sup>13</sup> Community banks include all Call Report filers, commercial banks, and state savings banks with assets of \$1 billion or less.



Reflecting the comparatively lower level of economic growth in recent years and perhaps reduced market opportunity, the number of bank participants has changed little in Independent counties. In any event, given the high ratio of community banks and the lack of economic diversification, these counties may be exposed to greater risk if key local industries experience financial difficulty and lay off workers.

The economies of Mixed counties generally appear to be in a transitional stage because they continue to be affected by traditional industries, yet there may be an increasing spillover effect from bordering metropolitan areas. These counties experience faster economic growth than their Independent counterparts, and insured institutions may benefit from this growth. Should both the local industries and the bordering metropolitan area experience economic downturns concurrently, these counties could be adversely affected.

Despite not bordering a metropolitan area, Not-Adjacent counties with at least ten insured institutions accepting deposits generally have achieved a solid level of job growth and high levels of economic diversity. Such factors may be contributing to market opportunities that have supported the expansion of the local banking industry in recent years.

In conclusion, non-metropolitan counties in the Atlanta Region do not have homogeneous structures, and this presents both challenges and opportunities. Proper identification of market forces, such as diverse economic drivers and strong competition, is important to insured institutions operating in these non-metropolitan areas. Slowing economic growth could accentuate any negative effects of these market forces.

*By the Atlanta Region Staff*



## *Slowing Economy Reduces Demand for U.S. Office Space*

- Demand for U.S. office space contracted during the first half of this year as the amount of newly vacated space exceeded the amount of newly occupied space for the first time since at least 1981.
- The U.S. office vacancy rate jumped 250 basis points in the first half of 2001, from 8.3 percent to 10.8 percent.
- With construction levels remaining high and demand still weak, the vacancy rate could rise further by year-end.

### *Overview*

Commercial real estate (CRE) markets traditionally have been—and remain—highly cyclical. During the 1990s, most U.S. office markets experienced a strong upswing. However, declining office employment growth along with other recent signs point to a possible downturn. As reported by *Torto Wheaton Research* (TWR), the U.S. office vacancy rate, which stood at a 19-year low of 8.3 percent at the end of 2000, jumped in only six months to 10.8 percent, the largest six-month increase in the 20 years TWR has tracked these data. Office vacancy increases range from modest levels in some markets to high levels in markets where supply and demand imbalances are more pronounced.

An uptick in construction activity combined with a substantial drop in demand for office space has led to a slackening of office market conditions. In light of the ongoing uncertainty as to the near-term direction of the U.S. economy, these trends make the current situation difficult for office market participants to read.

This article reviews recent developments in U.S. office markets and describes demand-side and supply-side trends that have contributed to the recent weakness.<sup>1</sup> It notes the role played by the changing fortunes of

high-tech firms in a number of metropolitan areas and how this situation has increased the volume of space available for sublease. Finally, the article focuses on the local construction loan exposures of insured banks and thrifts that have the task of managing their risks under changing market conditions.

### *Vacancy Rates Have Risen Quickly from Cyclical Lows*

At year-end 2000, the U.S. office vacancy rate stood at 8.3 percent—a 19-year low. Many individual metro areas posted even lower vacancy rates. For example, at year-end 2000, vacancies were 4.4 percent of available space in Seattle, 1.3 percent in San Jose, and 3.0 percent in Oakland. Beginning with first quarter 2001, as a result of a slowing economy and the fallout from the so-called “tech-wreck,” the U.S. vacancy rate rose by 120 basis points to 9.5 percent—the highest absolute quarterly increase since these data were first published in 1981. Another record increase of 130 basis points occurred during the second quarter, bringing the vacancy rate to 10.8 percent. To put these increases in perspective, consider that the national office vacancy rate has increased more than 50 basis points in any given quarter only twice.<sup>2</sup> Nonetheless, the current vacancy rate of 10.8 percent remains low by historical standards, as the average rate for the past 20 years has been 13.9 percent.

Most of the nation’s large metro areas saw increases in office vacancies during the first half of 2001. Forty-eight of the 53 major metropolitan areas tracked by TWR recorded a higher vacancy rate in June 2001 than at year-end 2000. Thirty-eight markets experienced increases of at least 100 basis points, and four markets saw vacancy rates jump by more than 600 basis points. As shown in Table 1 (next page), most of the markets experiencing the largest jump in vacancy rates also are home to concentrations of high-tech employment.<sup>3</sup> As

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<sup>1</sup> For further discussion of demand and supply trends, see Sally Gordon, “CMBS: Red – Yellow – Green™ Update, Second Quarter 2001 Quarterly Assessment of U.S. Property Markets,” *Moody’s Investors Service*, July 6, 2001.

<sup>2</sup> TWR notes increases of 60 basis points in the second quarter of 1989 and in the first quarter of 1999.

<sup>3</sup> Seven of the ten markets with the highest first-half 2001 vacancy rate increases are also among the top ten cities having the greatest levels of high-tech employment.

TABLE 1

IN MANY MARKETS, OFFICE VACANCY RATES REFLECT CONCENTRATIONS OF HIGH-TECH EMPLOYMENT				
METRO AREA	VACANCY RATE AS OF 6/30/01 (%)	VACANCY RATE AS OF 12/31/00 (%)	INCREASE IN VACANCY RATE (BASIS POINTS)	HIGH-TECH AS % OF TOTAL MARKET EMPLOYMENT
AUSTIN	11.8	5.0	680	10.1
SAN JOSE	8.1	1.3	680	27.4
OAKLAND	9.3	3.0	630	6.5
SAN FRANCISCO	10.3	4.1	620	8.3
SEATTLE	9.4	4.4	500	6.6
KANSAS CITY	15.9	11.0	490	2.7
BOSTON	8.7	3.9	480	8.2
PHOENIX	16.9	12.5	440	4.7
WILMINGTON, DE	10.4	6.2	420	3.8
WASHINGTON, DC	7.8	3.9	390	7.8
NATION	10.8	8.3	250	4.8

SOURCES: TORTO WHEATON RESEARCH, ECONOMY.COM, INC.

high-tech markets spurred higher demand for office space in the recent past, these markets are now giving back greater quantities of previously occupied office space. Table 2 (see page 18) lists office vacancy rates and changes along with lending concentrations, construction activity levels, and high-tech employment percentages for 53 major metropolitan areas and for the nation.

Unlike the last cycle, during which office vacancies shot up primarily in overbuilt downtown areas, recent increases are occurring more sharply in suburban than downtown sections of metropolitan areas. As of June 30, 2001, the average downtown office vacancy rate was 8.5 percent, and the average for suburban markets was 12.1 percent. Increases in office availability are dispersed among Class A office properties as well as Class B/C properties, yet vacancy rates do show disparities across many submarkets. For example, the South of Market area in San Francisco reports significantly higher office vacancy rates than the Financial District.<sup>4</sup> Similarly, in the Washington, DC, metropolitan area, the technology-intensive northern Virginia office market has experienced higher office vacancy increases than downtown Washington, DC, or suburban Maryland.

<sup>4</sup> Louis, Arthur M. July 24, 2001. "Empty Offices, Economic Downturn, Overconstruction Leave Commercial Landlords with More Space on their Hands." *San Francisco Chronicle*.

## Office Demand Drops

Net absorption, the primary indicator of demand for office space, was negative during first quarter 2001 for the first time since TWR began reporting the series.<sup>5</sup> (Negative absorption occurs when space returned to the market by existing tenants exceeds the space occupied by new tenants.) This negative performance was repeated in the second quarter. The decline in the volume of competitively leased space totaled 30 million square feet during the first half of 2001. (See Chart 1.)

The bulk of negative absorption in the first half of 2001 is due to the return of office space to the market through subleasing.<sup>6</sup> TWR reports that there were 43 million square feet of space "give-backs" through subleasing in the first half of 2001, and after offsetting absorption of 13 million square feet, negative absorption was 30 million square feet.

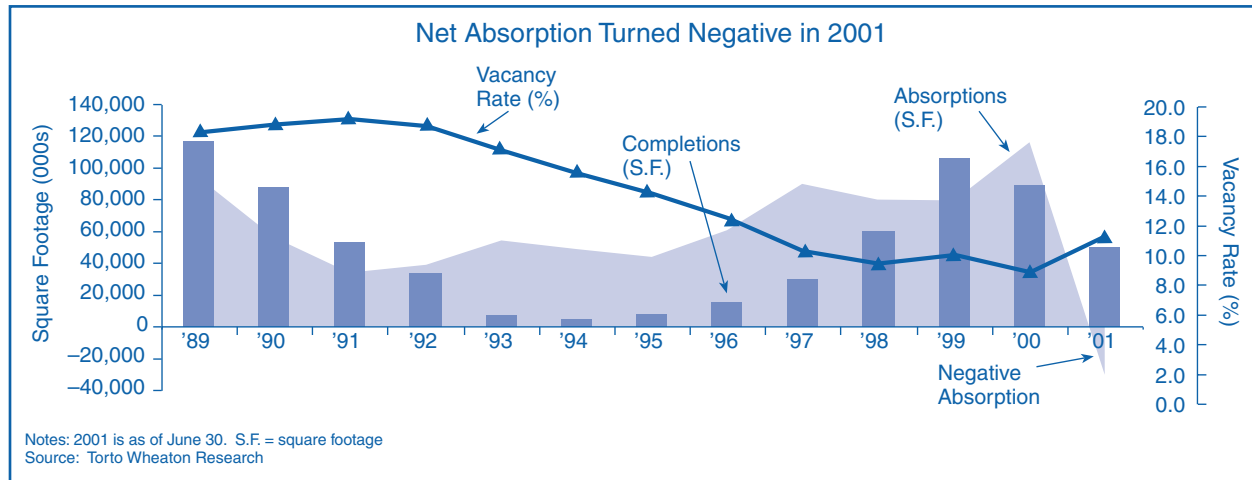
Office employment growth, the source of new office space demand, tends to be driven by the finance and services sectors.<sup>7</sup> Year-over-year job growth in the finance,

<sup>5</sup> Net absorption is the net change in total competitively leased space per period, as measured in square feet.

<sup>6</sup> In some metropolitan areas, over half the total office space available for rent (vacant space) is sublease space.

<sup>7</sup> TWR constructs its office employment index based on trends in the FIRE sector plus selected categories of the services sector. See *TWR Office Outlook*, Spring 2001, Vol. II, p. A.1.

CHART 1



insurance, and real estate (FIRE) and services sectors combined was more than 3 percent in every month from January 1993 through June 2000. Since the middle of 2000, job growth in these sectors has fallen steadily to a year-over-year rate of less than 1.5 percent in June 2001. A spring 2001 survey conducted by **Salomon Smith Barney** indicated that tenants estimated their growth in office space demand to be only 0.6 percent over the following 12-month period.<sup>8</sup> Also contributing to reductions in demand are increases in worker layoffs. Announced layoffs during the first seven months of 2001 totaled over 983,000 individuals, more than triple the number of announced layoffs during the same period last year.<sup>9</sup>

The slowdown in the demand for office space contrasts sharply with the situation last year, when absorption rates and office employment growth were robust in most markets, and leases were executed quickly for newly constructed properties. As shown in Chart 2, absorption of office space in 2000 actually outstripped the trend in office employment by a considerable margin. Why? With relatively easy access to initial public offering and venture capital funding, many startup firms anticipated rapid growth and leased office properties accordingly. In fact, venture capital funding facilitated historically higher rates of office space absorption by high-tech and other startups. In active bidding wars, new high-tech firms increased their office space holdings. A phenomenon of *space hoarding* developed in which some high-tech companies leased large quantities of office space in anticipation of future expansion.

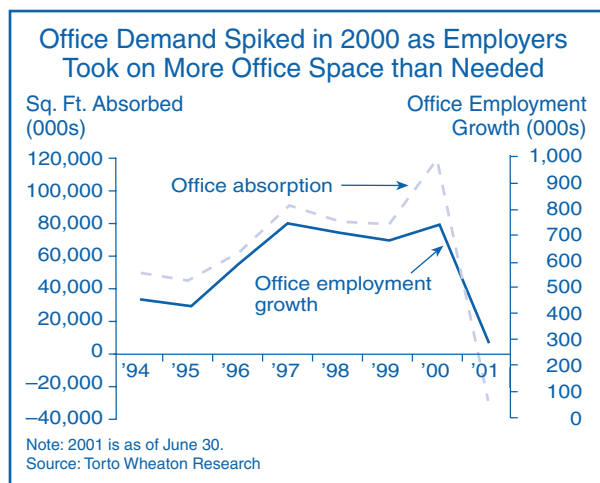
<sup>8</sup> Boston, Gary, Ross Nussbaum, and Jonathan Litt. May 16, 2001. "Real Estate Demand Survey." *Equity Research: United States, Real Estate Investment Trusts*. Salomon Smith Barney.

<sup>9</sup> Data provided to Haver Analytics by Challenger, Gray & Christmas.

More recently, because of a slowing economy, curtailed funding, and failures to achieve sales expectations, many high-tech and dot-com firms have closed or scaled back operations significantly. At the same time, traditional firms have reconsidered plans to expand, adopting a "wait and see" attitude. Consequently, as demand for space declines, large blocks of office space are returning to markets for sublease.

Space available for sublease is similar to landlord-offered space available for rent—space under both categories should count toward a market's available rental space. However, in the case of subleasing, tenants, rather than landlords, offer properties for rent. Tenants may attempt to sublease the property themselves or use a broker; however, in general, only space handled by a broker is included in the tally of a market's available rental space. Consequently, current office vacancy increases could be higher than reported.

CHART 2



### Meanwhile, Construction Continues

An uptick in office construction activity that began in many metro areas during the late 1990s has been a key element contributing to recent increases in office vacancies. According to the **Bureau of the Census**, U.S. expenditures on office construction totaled \$47.5 billion in 2000, continuing a seven-year cycle of expansion. Adjusted for inflation, this amount represents about 78 percent of the peak level of office construction expenditures that occurred in 1985. Recently, the pace of construction has slowed slightly, falling to an annualized rate of \$44.3 billion in May 2001.

Reflecting these large dollar outlays on office construction, TWR projected in December 2000 that 111.3 million square feet of new office space (or 3.6 percent of existing stock) would be completed during 2001. This newly completed space will come on the market following a period of rising construction activity from 1998 through 2000, during which the volume of completed office space averaged 84.9 million square feet per year. As shown in Chart 3, however, current office construction activity as a percentage of existing stock falls well below that of the 1980s.

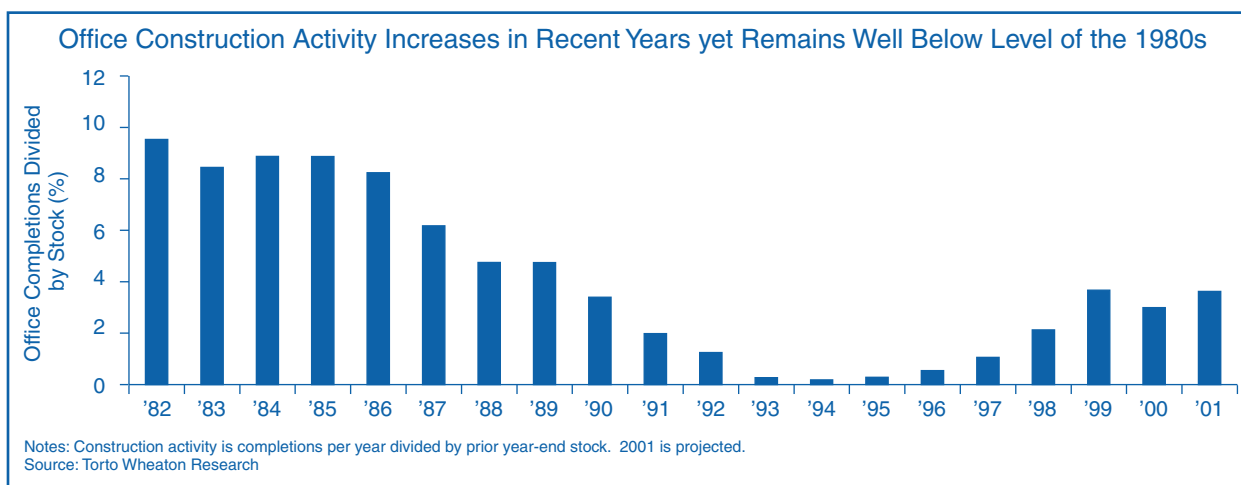
Many metropolitan areas currently experiencing high levels of construction activity also are seeing the largest increases in office vacancies. For example, cities that are positioned toward the upper right quadrant of Chart 4 are characterized by higher vacancy rate increases and more new office space construction. The ten cities with the highest first-half 2001 vacancy rate increases had total square footage of under-construction office space at 6.5 percent of existing stock as of year-end 2000.<sup>10</sup> By comparison, total office space under construction nationally was 4.5 percent of existing stock.<sup>11</sup>

Even as most projects move toward completion, some developers are reconsidering office construction plans. Builders have stopped construction of significant projects midstream in the Austin, Dallas, Seattle, and northern Virginia markets in response to retrenchment by major tenants and competition from subleased space.

### Softening Extends to Other Commercial Real Estate

Other major commercial real estate markets are also feeling the effects of a slowing economy and, with the exception of the retail sector, are experiencing increasing vacancy rates.

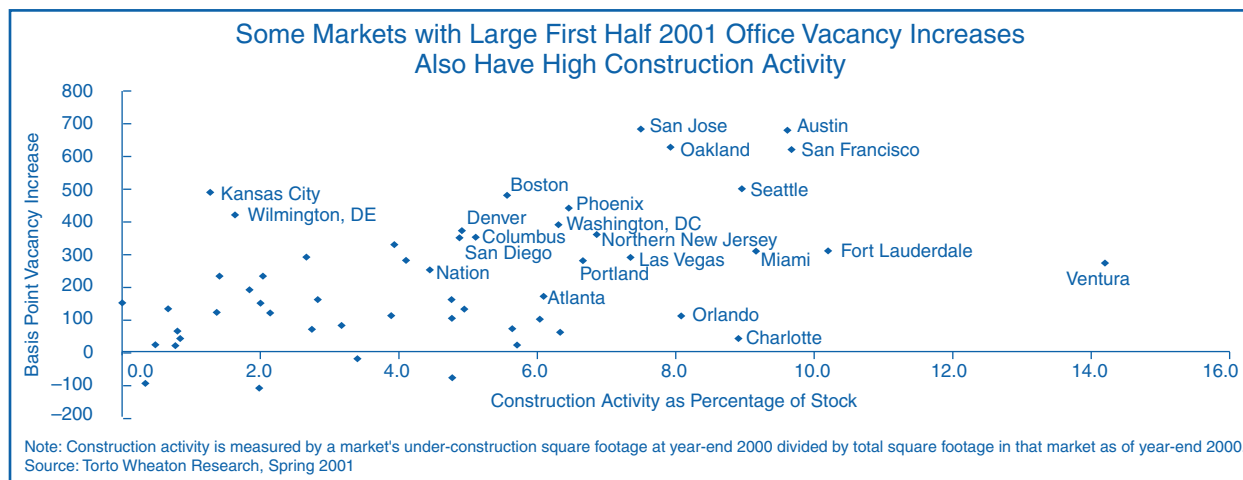
CHART 3



<sup>10</sup> One measure of a metropolitan area's exposure to overbuilding and rising vacancy rates is the degree of construction activity. This measure is found by dividing a metropolitan area's completions square footage or the under-construction square footage by the total stock of office property.

<sup>11</sup> The national 4.5 percent level for office properties *under construction* at December 2000 is higher than the 3.6 percent level for projected *completions* in 2001 because not all properties being built in 2001 will be completed during the year.

CHART 4



**Industrial** vacancy rates had fared well in recent years. As of year-end 2000, the national vacancy rate of 6.7 percent was the lowest since 1984. Now, however, a 150-basis-point increase has occurred, with industrial vacancies increasing to 8.2 percent in the first half of 2001.<sup>12</sup>

As the economy and the nation's high-tech and manufacturing sectors continue to slow, demand for industrial space for research and development and storage and distribution is declining. Industrial property subleasing is on the rise, and negative absorption occurred in the first half of 2001. At the same time, completions of industrial space during 2001 are estimated to exceed 220 million square feet, the highest level since 1988. Landlords are offering concessions, such as lease terms of one year compared with five to ten years, in an attempt to attract new tenants.

Industrial properties are somewhat less exposed to risks from overbuilding than office properties because of shorter construction periods and the ability to respond quickly to any change in demand. An exception is the *telecommunication hotel*,<sup>13</sup> a new entry into this market. This property type is characterized by a longer construction cycle and the fact that it typically has a "single use" design. In recent months, construction of these structures began in many high-tech markets to provide enhanced levels of data service. With declining demand, some telecom hotels stand vacant.

<sup>12</sup> Torto Wheaton Research.

<sup>13</sup> Telecom hotels are large, high-energy-consuming warehouses that house machinery, servers, routers, and switches that are the physical underpinning of the electronic commerce conducted on the Internet. They are hotels in the sense that they house equipment belonging to many different telecommunication companies. John Holusha, "Home for Machinery of the Internet," *The New York Times*, August 16, 2000.

The demand for **hotel** rooms is adversely affected by a slowing economy. Businesses have cut travel budgets and consumers have scaled back leisure plans, contributing to a decline in occupancy levels and revenue per available hotel room in most markets throughout 2001. Currently, upscale and luxury hotels are suffering more than limited service hotels. According to *Smith Travel Research*, limited service hotels, particularly budget hotels, represent the only lodging sector with higher occupancy levels through the first four months of 2001 when compared to the same four month period in 2000.

The supply of new hotel properties is lower than in the past, as financing for new hotel construction for the most part has been curtailed in recent years. However, limited service hotels are reported to be overbuilt in a number of markets in the Southeast and Southwest.<sup>14</sup> Annualized expenditures for new construction of all hotel types were \$12.1 billion as of May 2001, falling to the lowest level since 1996.<sup>15</sup>

The **multifamily** sector has experienced robust construction and equally strong absorption in recent years as new household formation, the driver for apartment demand, continues to increase. Annualized construction expenditures of \$25.5 billion as of May 2001 were at the highest level since 1989.<sup>16</sup> Despite the relative equilibrium between supply and demand for apartments in most markets, vacancy increases and rent declines are occurring in some locations. This decline has been most acute

<sup>14</sup> Kozel, Peter P. June 18, 2001. "U.S. Commercial Property Markets in a Slowing Economy: Implications for CMBS Credit Performance." *Standard and Poor's Structured Finance*.

<sup>15</sup> Data provided to Haver Analytics by U.S. Bureau of the Census.

<sup>16</sup> Ibid.



in the more concentrated high-tech markets, such as San Francisco, where reported average rental rates dropped 8.1 percent between the end of March and the end of May 2001.<sup>17</sup>

Despite a slowing economy, the **retail** sector has performed reasonably well, as consumers maintain relatively high spending levels. Many of the store closings in 2000 and 2001 have been absorbed by new tenants as landlords have acted quickly to avoid letting vacant space linger. Meanwhile, robust construction has continued, with total expenditures in 2000 of \$52.6 billion and an annualized level of \$52.2 billion as of May 2001. Each of these two years' expenditure levels exceeds all previous years' retail construction amounts since data were first gathered in 1964.<sup>18</sup>

Taking note of the robust level of retail construction activity, a recent **Moody's** article finds that the nation's mall retail and "power center"<sup>19</sup> space grew by 3.3 percent in 2000, while population growth expanded by only 1.2 percent. The article raises concerns for potential excess supply of retail space resulting from a construction rate that is almost triple the population growth rate.<sup>20</sup> A negative consequence of the high rate of retail construction is found in a recent **Standard and Poor's** study. This article points out that most of the retail mortgages (held in commercial mortgage-backed pools of assets) that defaulted during 2000 did so because of competition from new retail establishments.<sup>21</sup>

### ***Implications for Insured Institutions***

Office vacancy rates during the first half of 2001 increased at an unprecedented rate. What does this mean for insured institutions? On the one hand, at mid-2001 vacancy rates remained below their 20-year average. Yet the speed of the increase and the number of

metropolitan areas that have experienced softening make this a trend that deserves the close attention of insured institutions, especially those with significant concentrations in commercial real estate and construction lending.

Financial indicators of real estate credit quality in banking remain favorable, with losses and delinquencies trending up modestly from minimal levels. Noncurrent construction and development (C&D) loans as of March 31, 2001, remain at a relatively low .92 percent of all outstanding C&D loans. (Noncurrent C&D loans as a percentage of all C&D loans averaged .93 percent for the past five year-ends.) Similarly, noncurrent CRE loans<sup>22</sup> as of March 31, 2001, were .82 percent of all CRE loans, a level consistent with the average for this ratio of 1.08 percent for the past five year-ends. Charge-off ratios at March 31, 2001, for both C&D and CRE loans were each at .02 percent and remain below the averages of .05 percent for each for the past five year-ends. These favorable numbers are the legacy of a strong economic expansion, whereas current economic events suggest the potential for future deterioration in credit quality.

The outlook for commercial real estate credit quality depends on the depth and duration of the current economic slowdown and on the risk management practices of each institution. In this regard, as signs of increasing risk materialize in conjunction with a declining economy, lenders appear to be managing risks prudently and avoiding speculative lending.<sup>23</sup> Anecdotal information suggests that borrowers are pressed to obtain higher prelease commitment levels in order to gain loan approvals. In addition, lenders are requiring more up-front equity.<sup>24,25</sup>

The importance of risk management practices is magnified by the heightened lending concentrations currently prevailing at some banks. Institutions with elevated concentrations in CRE and C&D lending have been more likely to experience significant problems during times of economic stress (for further details,

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<sup>17</sup> Associated Press, News in Brief from the San Francisco Bay Area, June 13, 2001.

<sup>18</sup> Data provided to Haver Analytics by U.S. Bureau of the Census.

<sup>19</sup> According to the Urban Land Institute, a power center is a community shopping center in which at least 75 to 90 percent of the selling space is devoted to multiple off-price anchors and a discount department store or warehouse club. It is the "power" of its anchors that gives the center its name.

<sup>20</sup> Sally Gordon, op. cit.

<sup>21</sup> Kozel, Peter P. April 20, 2001. "Outlook for Property Markets in a Slower-Growing Economy and the Implications for CMBS Credit Performance." *Standard & Poor's Structured Finance*.

<sup>22</sup> CRE loans are nonfarm, nonresidential loans secured by real estate.

<sup>23</sup> Speculative construction lending is defined as a loan not accompanied by a meaningful presale, prelease, or take-out commitment.

<sup>24</sup> "Capital Is Still Plentiful for Right Projects." *Midwest Real Estate News*. July 2001. Vol. 17, No. 7.

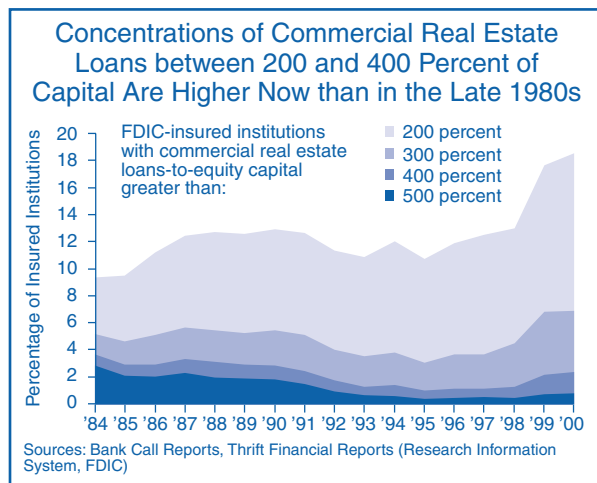
<sup>25</sup> Further information on bank underwriting practices can be found in Federal Deposit Insurance Corporation, Division of Research and Statistics, *Report on Underwriting Practices*, <http://www.fdic.gov/bank/analytical/report/index.html>.

see *History of the Eighties*<sup>26</sup>). As shown in Chart 5, the percentage of insured institutions with commercial real estate loan concentrations between 200 and 400 percent of capital is higher now than it was in the late 1980s. However, there are relatively fewer institutions at the highest concentration level, in excess of 500 percent of capital. In fact, fewer than 1 percent of insured institutions are at this level. A similar story holds true for construction loans, as the increasing concentrations are in the range of 100 to 300 percent of capital (see Chart 6).

There are a number of issues for construction lenders and commercial real estate lenders to consider going forward. Because uncovered loans (C&D loans made without assurances of a firm take-out commitment) tend to be higher-risk, an important part of managing the risk in construction lending has traditionally been the lender's ability to obtain a take-out commitment.

Sources of take-outs for C&D loans include other insured institutions, pension funds, foreign investors, and life insurance companies, along with public-market real estate investment trusts (REITs) and conventional mortgage-backed securities (CMBs). Anecdotal reports indicate that shifts in market sentiment in recent months have resulted in lowered investments in REITs and consequently less available capital for REITs to purchase real estate.<sup>27</sup> Insured institutions

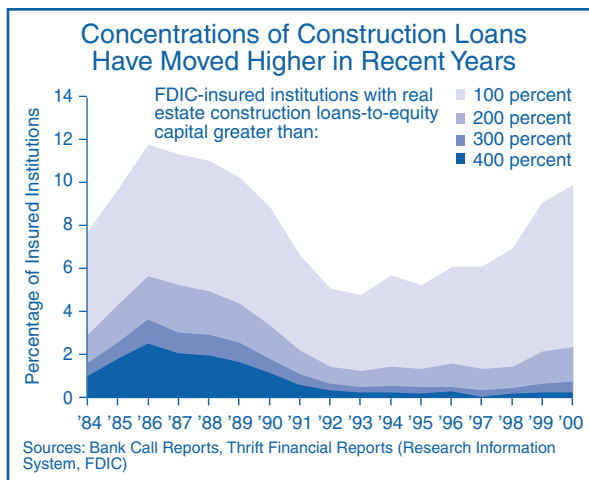
**CHART 5**



<sup>26</sup> Federal Deposit Insurance Corporation. *History of the Eighties—Lessons for the Future, Vol. 1: An Examination of the Banking Crises of the 1980s and Early 1990s*, Chapters 9 and 10. 1997. Washington, DC: FDIC. <http://www.fdic.gov/bank/historical/history/index.html>.

<sup>27</sup> Smith, Ray A. August 1, 2001. "Property Held by Public Firms Drops." *The Wall Street Journal*.

**CHART 6**



may face increased challenges to convert construction and development loans into permanent loans should the reported REIT situation become a trend and other sources of permanent capital become less available to purchase C&D loans.

Monitoring economic trends in general, and local real estate trends in particular, becomes even more important during a time of rapid change in market conditions. For example, reliance on appraisals based on outdated or top-of-market assumptions can result in a divergence between expected and realized collateral values or cash flows. Similarly, while preleasing commitments offer significant risk-reduction benefits to lenders, during a time of weakening economic conditions there is at least the possibility that a prospective tenant will be unable to honor a lease obligation, as has been the case with some firms in the high-tech sector in recent months.

### Conclusion

Office market trends cannot, of course, be considered in isolation. The recent softening in office markets is a symptom of a slowing economy coupled with a rapid decline in the fortunes of some high-tech firms. Considered in this broader context, the challenge for insured institutions is simply to ensure that risk-management strategies are in place that will succeed under a more challenging economic environment.

Thomas A. Murray  
Senior Financial Analyst

**TABLE 2**

OFFICE MARKET AND BANKING DATA ON 53 METROPOLITAN AREAS						
METROPOLITAN STATISTICAL AREA	2ND QUARTER 2001 OFFICE VACANCY	BASIS POINT INCREASE FROM YEAR END 2000	COUNT OF COMMUNITY BANKS WITH C&D LOANS	MEDIAN C&D AS PERCENTAGE OF TIER 1 CAPITAL AT 3/31/2001 (%)	HIGH-TECH AS PERCENTAGE OF TOTAL MARKET EMPLOYMENT (%)	OFFICE SPACE UNDER CONST/ STOCK AT 12/31/2000 (%)
ALBUQUERQUE	11.6	-110	9	61.0	6.8	2.0
ATLANTA	9.8	170	76	172.2	3.8	6.1
AUSTIN	11.8	680	20	53.4	10.1	9.6
BALTIMORE	8.9	60	60	22.8	3.6	6.3
BOSTON	8.7	480	100	24.1	8.2	5.6
CHARLOTTE	9.0	40	20	48.5	1.7	8.9
CHICAGO	8.9	130	225	33.5	4.5	4.9
CINCINNATI	10.1	100	58	32.6	3.1	6.0
CLEVELAND	13.6	40	16	34.8	3.0	0.8
COLUMBUS, OH	16.9	350	20	22.4	3.1	5.1
DALLAS	16.4	110	75	84.5	6.5	3.9
DENVER	12.7	370	45	70.4	5.2	4.9
DETROIT	12.0	160	28	35.2	3.1	2.8
FT. LAUDERDALE	12.8	310	13	19.1	2.7	10.2
FT. WORTH	16.4	130	36	71.8	3.4	0.7
FRESNO	14.4	20	5	196.0	0.9	0.8
HARTFORD	14.0	150	11	25.2	3.5	0.0
HONOLULU	12.6	-190	3	11.4	0.9	0.0
HOUSTON	13.6	60	48	65.8	3.1	0.8
INDIANAPOLIS	15.8	120	21	29.6	3.3	1.4
JACKSONVILLE	11.7	-20	11	65.2	1.8	3.4
KANSAS CITY	15.9	490	86	70.8	2.7	1.3
LAS VEGAS	14.5	290	19	117.7	1.5	7.3
LONG ISLAND	10.9	190	6	19.1	5.3	1.8
LOS ANGELES	14.1	150	62	35.4	3.7	2.0
MIAMI	10.5	310	26	28.1	1.8	9.2
MINNEAPOLIS	10.8	20	119	44.0	6.0	5.7
NASHVILLE	12.8	230	20	78.4	1.2	2.0
NEW YORK	5.1	230	34	10.5	2.4	1.4
NORTHERN NEW JERSEY	10.9	360	66	15.0	5.6	6.9
OAKLAND	9.3	630	12	120.0	6.5	7.9
OKLAHOMA CITY	20.3	20	44	57.8	2.6	0.5
ORANGE COUNTY	14.7	330	14	34.5	6.4	3.9
ORLANDO	13.1	110	23	72.1	2.3	8.1
PHILADELPHIA	10.7	80	68	22.1	4.5	3.2
PHOENIX	16.9	440	27	114.2	4.7	6.5
PORTLAND, OR	9.9	280	14	118.8	6.6	6.7
RIVERSIDE	14.4	-100	18	143.5	1.6	0.3
SACRAMENTO	6.6	70	11	106.9	3.9	5.6
SALT LAKE CITY	15.3	280	14	111.7	4.5	4.1

**TABLE 2 (CONTINUED)**

OFFICE MARKET AND BANKING DATA ON 53 METROPOLITAN AREAS						
METROPOLITAN STATISTICAL AREA	2ND QUARTER 2001 OFFICE VACANCY	BASIS POINT INCREASE FROM YEAR-END 2000	COUNT OF COMMUNITY BANKS WITH C&D LOANS	MEDIAN C&D AS PERCENTAGE OF TIER 1 CAPITAL AT 3/31/2001 (%)	HIGH-TECH AS PERCENTAGE OF TOTAL MARKET EMPLOYMENT (%)	OFFICE SPACE UNDER CONST/ STOCK AT 12/31/2000 (%)
SAN DIEGO	9.7	350	21	57.5	6.6	4.9
SAN FRANCISCO	10.3	620	21	69.0	8.3	9.7
SAN JOSE	8.1	680	5	174.5	27.4	7.5
SEATTLE	9.4	500	30	77.1	6.6	9.0
ST. LOUIS	10.1	-80	80	40.4	2.6	4.8
STAMFORD	11.2	290	10	43.5	5.6	2.6
TAMPA	14.8	70	33	40.0	4.2	2.7
TUCSON	8.8	100	3	178.4	4.4	4.8
VENTURA	14.2	270	8	49.7	5.4	14.2
WASHINGTON, DC	7.8	390	61	51.1	7.8	6.3
WILMINGTON, DE	10.4	420	12	28.4	3.8	1.6
W. PALM BEACH	12.2	160	18	37.2	2.3	4.8
WESTCHESTER	12.5	120	4	19.5	12.3	2.1
NATION	10.8	250	(1) 3,801	(1) 40.1	(2) 4.8	(2) 4.5
NOTES: ONLY COMMUNITY BANKS WITH CONSTRUCTION LOANS ARE INCLUDED IN THIS TABLE. COMMUNITY BANKS ARE INSTITUTIONS WITH ASSETS LESS THAN \$1 BILLION. NONCOMMUNITY BANKS ARE EXCLUDED BECAUSE THEIR LENDING ACTIVITIES ARE LIKELY TO SPAN A LARGER AREA THAN THE MSA IN WHICH THEY ARE HEADQUARTERED. SOURCES: TORTO WHEATON RESEARCH; BANK AND THRIFT CALL REPORTS, FDIC RESEARCH INFORMATION SYSTEM DATA; ECONOMY.COM, INC. 1. ONLY COMMUNITY BANKS WITH CONSTRUCTION LOANS AND LOCATED WITHIN A MSA ARE INCLUDED IN THESE FIGURES. 2. PERCENTAGES SHOWN ARE THE AVERAGES FOR THE 53 METROPOLITAN AREAS.						

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